

# City of Detroit

## CITY COUNCIL

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**To:** Honorable City Council

**From:** David D. Whitaker, Director  
Research and Analysis Division (RAD) Staff

**Re:** **LATEST DRAFT “FINANCIAL STABILITY AGREEMENT”  
(3/29/12 version)**

**Date:** April 2, 2012

Council has requested that RAD provide a report regarding the most recent version of a proposed “Financial Stability Agreement” (FSA) (**attached**). Time is of the essence. Therefore, RAD is providing this interim report.<sup>1</sup>

**The document under consideration is certainly one of the most important government documents – perhaps the most important – in the City’s history. The inadequate time period to discuss, analyze and understand its full, detailed consequences looms over this entire discussion and its ultimate resolution.**

The proposed agreement initially retains virtually all of City officials’ existing powers under the Home Rule City Charter, adding a Chief Financial Officer with oversight and collaboration of a Financial Advisory Board (FAB) and a Program Management Director (PMD), as well as the State Treasury Department. However, these powers are greatly compromised through the various provisions in the FSA. Specifically, regarding City Council, the Council’s authority over contracts, settlement of claims valued over \$250,000, and ratification of collective bargaining agreements is conditioned on concurrence with the FAB. In the event disputes arise over execution of the FSA reform initiatives, City government officials’ ability to self-govern is by

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<sup>1</sup> Full and adequate discussion of all the relevant legal, policy and contractual implementation issues would take more time than allowed for Council Members to read this report and vote, before a deadline of Thursday, April 5, 2012, regarding a document provided to RAD on Thursday afternoon, March 29, 2012. Exploring and analyzing all the issues raised in this proposed document (which itself is not even finalized as yet) would take at least a week, or more likely two or more. This report must be issued now so that Council Members may actually read and discuss it before voting on the proposal. RAD is continuing to prepare an analysis of statutes cited in the FSA. Reference should be made to RAD’s three recent privileged reports dated March 19, 2012 (The State “Consent Agreement” and Overview of Municipal Bankruptcy Process), and March 25, 2012 (Public Act 4 Timing Requirements) for relevant background and developments leading up to this point.

the terms of this agreement ceded to the Financial Advisory Board. Potential choices in opposition to those of the Program Management Director would likely be defined as “Reform Default Condition.” The proposed agreement provides in that event for transferring the powers of City government to the FAB, at least in areas where the City fails to measure up to the expectations of the Financial Advisory Board or the Program Management Director, and/or fails to follow State directives.

In essence then, this agreement sets up a “parallel” State oversight governance structure:

- Both the Mayor and the City Council are left intact, although their powers are in some cases conditioned on State approval and otherwise ceded or constrained as discussed throughout this report.
- The State Financial Advisory Board’s structure is modified from the original 6-3 proposal to reflect State control by a 5-4 vote.
- The tie-breaking vote on the FAB belongs to an official whose joint appointment by the Governor and Mayor is subject to approval by Council.
- The powerful “Program Management Director” would have the ability, with Board approval, to design, develop, implement and execute the new reform operational structure of City government, particularly with regard to the items enumerated in Annex B - which are largely undefined in the FSA. S/he could take control of disputed areas of policy and spending from the City, without the ability of the City to effectively oppose it.<sup>2</sup>

The terms of the document itself do not premise such a conditional right to control on any corresponding cash contribution<sup>3</sup> to the City’s budget for services to Detroit residents. Council has requested a list of “pros” and “cons” for this decision.

Reasons “FOR” entering into such an agreement include:

- The City’s truly desperate financial straits – annual budget deficits, sustained structural deficits and unsustainable pension and health care debt obligations that have been well documented by CAFRs as well as other credible sources, including the Ernst & Young accounting firm, the Citizens Research Council and City Council’s own Fiscal Analysis Division;
- A significant recent history of the City’s chronic inability to make effective changes in government operations and spending patterns commensurate with the City’s fiscal challenges, as required by the Glenn Steil State Revenue Sharing Act and the Uniform Budgeting and Accounting Act, resulting in failures to adopt budget amendments on a timely basis when projected revenues and expenditures are contradicted by actual experience;

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<sup>2</sup> S/he could not do this as broadly as an “Emergency Manager” under Public Act 4, but absolutely within any specific areas of dispute, in the event that the Mayor and Council do not follow the State’s directions.

<sup>3</sup> Although the State is not putting any money into the agreement, the City will presumably realize cost savings from the State providing in-kind technical assistance with services like cash stabilization, payroll upgrades, systems integration and income tax collection (see attached Section 2.5, Pp. 16-17). There would be significant costs to the City of Detroit if it had to pay for these systems and technical assistance itself, which is one of the reasons these reforms have not yet been adopted.

- The chronic, continuing failure to produce and implement an adequate financial structure with a deficit elimination plan;
- Some practical suggestions for reform are contained within the document, like a somewhat refined version of the Charter-mandated revenue-estimating conference, as well as the express intent to confront a number of items generically identified in “Annex B” such as:
  - A long history of unrealistic, deficit-creating budget systems and procedures
  - The annual DDOT subsidy of \$50-100 million
  - PLD budget deficits
  - Insufficient income tax collection
  - Inefficient grants management
  - Increasing physical blight, in spite of intensified demolition
  - Unsustainable legacy costs for medical and pension benefits
  - Unmanageable collective bargaining negotiations and agreements
  - Expensive and ineffective risk elimination, reduction and management
  - Long term debt liability and the frequent use of costly debt instruments to “kick” an ever-growing “can” of debt “down the road”;
- The massive economic and political power of the State and corporate forces behind the proposal to strip away local government control;
- The lack of a readily available, practical alternative for addressing the fiscal challenges the City faces;
- The City’s need for stability and a positive sense of looking toward collaborative action for the future.

Reasons “AGAINST” entering into such an agreement include:

- The absence of a cash infusion (not based on further borrowing – e.g., government obligation bonds) accompanying the very significant increase in State control;
- Potential unintended adverse consequences of self-interested, overly hyped and poorly planned privatization, anti-labor power grabs and other vaguely referenced “reform” policies embedded in the document – which may ultimately lead to dismantling City government as reflected in the recently revised Home Rule Charter;
- Likely adverse reactions and consequences of what many see as a blatantly paternalistic narrative and consciousness that has permeated and dominated State and business community discourse regarding Detroit’s problems and the State’s proffered “solutions,” which amount to dissolution of the City and overriding the vote of its people ;
- It is an agreement conceived and born outside of the light shed by the Open Meetings Act, carrying with it a “backroom deal” odor, coupled with a general lack of candor about implications of Public Act 4 and other State policies vis-à-vis Detroit, such as revenue sharing and tax policies – all under the threat of “Do it or else!”

- The rush to judgment that, as noted above, requires City officials to make immediate decisions with likely vast historic importance, based on insufficient time to obtain and consider all the relevant consequences and potential alternatives;
- The projected need for the State and even the federal governments to step in and help fund local government operations in the City of Detroit, if the proffered FSA is unacceptable, in order to avoid political and economic disasters not only in Detroit, but in other areas they care about, including the fiscal health of the State itself;
- The agreement can be seen as the dismantling of City government, particularly considering the impact of items in Annex B. It appears that it is the intention to privatize many City functions such as transportation, lighting, health, human services, real estate development, permitting and business licensing. A question arises: what would be left of City government?
- Efforts to take over the pension systems seem to be included, which would mean another controversial effort to usurp governance of the City's systems without the benefit of payment, similar to recent governance changes for the Detroit Water and Sewerage Department;
- The treatment of the City's workforce, specifically the unions, will be fiercely opposed. The City recently asked them to bargain away some their rights to help with fiscal challenges. The unions bargained for concessions, resulting in significant potential cost savings. However, despite these efforts the Temporary Agreements are being disregarded and a laundry list of provisions that can be construed as excessive are being proposed by the State;
- The cumulative effect of some of the proposed changes is seen by some as the dismantling of the safety net for some of the City's most needy and vulnerable residents.

### **Discussion**

The Deputy Mayor stated on Thursday, March 29, 2012, that the latest draft FSA available to RAD, City Council and the public is not final, but close enough to merit broader discussion of necessary changes. As Your Honorable Body knows, RAD has not been a part, nor kept advised on a daily basis of the status, of the negotiations and the various interim draft documents that led up to this point. In general, the latest drafts reviewed by RAD within the last week go significantly further toward the objective of incorporating deficit reduction, budget balancing and operational reforms into a transformed City governance structure, as compared to the original document provided by the Governor and the State Treasurer, and analyzed in RAD 's previous report dated March 19, 2012. Many crucial issues are still stated generally however, with the specifics left to further work in the future.

Highlights of the new draft(s) developed since the March 19-23 time frame include:

- The causes and circumstances of the City's dire fiscal emergency, set forth in the first four (4) pages of non-binding "Whereas" clause recitals, are significantly rewritten to reflect a less overtly negative and blaming stance vis-a-vis the City (but not to reflect any culpability of any entities outside the City of Detroit's control, such as State or Federal regulatory or funding decisions, and particularly any windfall profit-seeking

behavior on the part of speculative institutional creditors whose claims have helped undermine City officials' ability to budget for adequate services to City residents, including Wall Street banking institutions in particular)<sup>4</sup> (**attached Pp. 1-4**);

- The power and authority of the State Treasury Department and the Review Team under Public Act 4, the “Emergency Manager” Act, are expressly invoked at multiple points, so that the document is likely to qualify as a “Consent Agreement” under the Act (**attached Pp. 26, 29, 33, 36 and signature p. 3 for the Financial Review Team**);
- The State invokes the International City Managers Association (ICMA) Code of Ethics (also attached) as the standard for conduct of members of the proposed Financial Advisory Board (**attached Pp. 8-9**);
- The State Treasury Department’s obligation, if any, to provide financial assistance to the Reform Program under this Agreement is subject to the will of the State Legislature, under the State Constitutional requirement “that no money may be paid out of the State treasury except in pursuance of appropriations made by law.” (**attached p. 20, paragraph 2.9**);
- A key term – “Set-Aside” – has been inserted as an item to be determined by the State Treasurer, and reviewed and approved by the Financial Advisory Board. [**attached p. 10, paragraph 1.5 (f)**] The phrase “Set-Aside” is subsequently defined as a “budget stabilization account” (a rainy day fund) to be established, reviewed and approved as part of the process of “Revenue Estimation” during the biannual “Revenue Conference” established by Section 8-213 of the City Charter [**attached Pp. 21-23, paragraphs 3.1 and 3.2, especially 3.1(c) and (d)**];
- The \$104 million in an escrow account authorized by City Council’s action on Tuesday, March 27, 2012, and derived from bonds issued and approved by the State Municipal Finance Agency (MFA), could only be withdrawn with the approval of the State Treasurer, in his discretion [**attached Pp. 16-17, paragraph 2.5 (a)**];
- The Financial Review Board would have the authority to approve or reject any proposed litigation settlement greater than \$250,000, and for such purposes the Board would be considered a client of the City’s Law Department (**attached Pp. 29-30, paragraph 5.1**);

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<sup>4</sup> The question of whether including such an analysis of major institutional creditors’ role in the City’s fiscal crisis would itself bring down an overt “takeover” of the City under Public Act 4, should that statute’s constitutionality be sustained, has been raised by residents’ comments during recent public meetings of City Council and the State’s Financial Review Team, but not explicitly addressed by representatives of either the State or the Administration in RAD’s presence during the negotiation and revisions process for the attached proposed “Fiscal Stability Agreement.” The extremely complex, technical and fact-specific role of financial instruments such as “interest rate swaps” in this crisis is one of the key issues whose complexity cannot be adequately analyzed within the time allowed for this report, but its potential significance should be noted.

- **The crux of the document is the consequences of a “Material Breach; Default” as determined by the Financial Advisory Board, or pursuant to written notice provided by the Program Management Director, resulting in the Board’s right to withhold funds, file suit<sup>5</sup> and exercise other remedies; “the Mayor shall be deemed to have delegated his executive authority with respect of the Reform Initiative or Initiatives for which a Reform Default has been declared ... to the Program Management Director; and the City Council, by approval of this Agreement, shall be deemed to have given full legislative approval and authority to proceed with the implementation and execution of such Reform Initiative or Initiatives...” (attached Pp. 31-35, paragraphs 6.2 – 6.4)** This seems to be in essence issue-by-issue “Emergency Management” authority, conditioned on whatever “Reform Default Condition(s)” the Board and the Program Management Director consider to be inadequate efforts at government reform by City officials;
- “Annex B” lists items in the City’s “Operational Reform Program;” projects for reforming City government on many levels.<sup>6</sup> The one-page document presents an enormous range of potential problems, due to its scope, brevity and lack of detail, require extensive discussion, and are addressed below.

Pursuant to the proposed FSA, it is the responsibility of the Program Management Director to implement “Reform Initiatives”, which are central to the Agreement. These initiatives include designing, developing, managing, implementing and executing each reform. The particulars of what each reform initiative will entail have not been articulated. Rather, a simple list of the broad areas and functions subject to these reform activities is attached to the document.

Annex B represents the “Phase I Reform” as referenced in section 2.4 of the agreement. Section 2.4(b) indicates: “By approval of this Agreement, the City Council has approved of the ‘Operational Reform Program’ attached hereto as Annex B and authorized its implementation.”<sup>7</sup>

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<sup>5</sup> Although this document clearly states that the FAB is a “public body politic,” a legal entity having the ability to sue and be sued in its own name, it is not immediately clear to RAD how FAB derives this power and standing through the provisions of this document, absent separate statutory authority to do so.

<sup>6</sup> The relevant Annexes are not attached, because they have changed so frequently, the most recent versions provided contain internal contradictions, and they are expected to change again before the proposed document is finalized, before this report can be provided and read, so as to avoid misinformation caused by attaching a document that is expected to be superseded by a subsequent version. The lack of a final version of Annex B in particular (defining the City Government Reform Program), as well as the extreme vagueness and generality of the version of Annex B provided on Thursday March 29, 2012, is a major concern in terms of inability to fully understand the ultimate implications of the proposed FSA.

<sup>7</sup> Note that Section 2.4(a) describes the “Operational Reform Program” as being “attached hereto as Annex B (the “Phase I Reform”). However, it appears that the general approval of the Operational Reform Program constitutes automatic approval of an undefined “Phase II” as well as the ill-defined list of reforms included in Annex B.

The section further mandates that the Council *shall* make such other changes in ordinances and resolutions as necessary to fully implement Annex B “as contemplated by this Agreement.”

Annex B, as attached to this Agreement, does not describe an “operational reform program.” It is merely a list of twenty subject headings referencing City programs and services, as well as internal City operations. The list encompasses much of the range of Executive Branch programs, services and activities described by the City Charter, and notes “changes”, “review” or “reform.”<sup>8</sup> Significantly, section 2.3 of the FSA also provides that the Program Management Director acts “in the place and stead of the Mayor and the City Council with respect to a Reform Initiative in the event that the Financial Advisory Board finds a Reform Default of the Agreement in respect of a Reform Initiative, as provided in and subject to Section 6.4 of this Agreement.” If Annex B is construed to fulfill the requirements of an Operational Reform Program, it is unclear what is actually “contemplated by this Agreement” that City Council is being asked to agree with. It leaves open questions whether City Council would have any authority to question or have any legal impact at all on the direction of any of the items contained on the list, if the body disagreed with desires of the Administration or the FAB.

The provisions that establish the definition of a “Reform Default” are found at section 6.4 (a). When a breach in the provisions of the Agreement (including the Annexes) has occurred or is imminently likely to occur, which is materially frustrating to the timely implementation of one or more of the Reform Initiatives, it constitutes a “Reform Default Condition.” After this default is reported to the Financial Advisory Board and the State Treasury Department, the City is provided a thirty-day window to cure the default, and then a hearing is granted to the City before the FAB to determine whether the default has been cured. The failure to cure can trigger significant penalties including a finding by the Board that the Mayor has delegated his executive authority to the Program Management Director. While the consequences of a reform default are clear, the actual definition of a “breach” or exactly what constitutes a default is extremely vague, especially when considering the wide area of activity of City functions delegated to the Program Management Director.

- “Annex C” sets forth a fairly detailed “Revenue Estimation and Budget Approval Calendar” for actions to be taken between December 8 and July 31 annually; and
- “Annex D” sets forth “Required Provisions of Collective Bargaining Agreements,” applicable after August 1, 2012.

Some of the questions Council Members may want to ask regarding the functions and implications of the proposed Financial Advisory Board could include the following:

- What checks and balances exist on the powers provided to the FAB? Only 2 of its members are “at-will” appointees. Since the others can only be removed for cause, what effectively constrains their power? **(Particularly where such an FAB is not**

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<sup>8</sup> Operational Reform Programs listed on Annex B include such nebulous and ill-defined areas as “Public Lighting Department Changes”, “DDOT Changes”, “Income Tax Collection”, “Fire Authority review”, and “Permits”.

**specifically provided for under Public Act 4 or other statutory authority RAD has been able to find under State law)**

- What procedures exist or what office/body can over-ride a decision of the FAB? What measurements exist to determine if the FAB is meeting its obligations?
- Since FAB members are compensated \$25,000 per year, how are the members and employees paid? They are not City employees, or City contractors. What is their formal legal status in City government? What specific budgetary appropriation funds will cover these items, especially during the current fiscal year?
- The FAB staff budget is up to \$1,000,000 per year – as agreed by the City and the Treasury Department. Is their budget subject to the City’s budget deliberations (i.e., established within the FAB)? What control does the City have if it is believed expenditures are excessive or not acceptable? Where will the FAB offices be located? Will their meetings be televised?
- The FAB is to adopt regulations governing procurement that are not subject to City rules or State rules/requirements. Are these procurement regulations to be written? Are they to be public? Are the regulations or requirements the FAB adopts subject to any oversight authority or challenge?
- The FAB is to approve all City contracts over \$250,000. Will this result in further delays to the contracts? (This question may be particularly significant, because it is not stated anywhere how often the FAB must meet to deliberate; normal City operations have required City Council action on contracts on at least a weekly basis.) Can the City Council not approve a contract the FAB has approved? What happens in the event of a conflict? Which decision prevails?
- What is the effect of the FAB’s authority to “review, assist, advise, comment and make recommendations?” Is the City ever free to ignore such recommendations, or will this invariably be considered a breach of the Agreement?
- The FSA requires the appointment of a Chief Financial Officer, the creation of the Program Management Office to implement the Reform Program, and appointment of Program Management Director. These appointments are for terms of 5 years, beyond the term of the Mayor and City Council, so will the next Mayor inherit both of these directors?
- Is there a requirement for staff supporting both of these directors? What is the estimated cost for each office? How is compensation determined? Are the Chief Financial Officer and Program Management Director required to report in person, or only to submit periodic written reports?
- The Treasury Department agrees to draft and present to the Governor for recommendation to the Legislature, measures to enable the City to achieve Reform objectives. What are the consequences if the Legislature fails to adopt measures presented to them? What input do the Mayor and City Council have to shape the proposed legislation?
- If the FAB determines there is a material breach of the Agreement, does the City – Mayor and/or City Council have any ability to challenge that determination in a court? If so, what are the procedures and standards for resolving such challenges?
- What measures can be provided to ensure the State and the Treasury Department actually follow-up with the “supportive activities” identified in Annex E? What remedies are available to the City if the State is in breach of this agreement?



- A number of the supportive measures are projects the State has already agreed to: e.g., the International Trade Crossing project, and improvements to I-94 from I-96 to Connor. They also include assistance with rebuilding Royal Oak and Troy rail stops – why is this part of the City of Detroit Agreement?
- Supportive Measures also refer to renovation of Shed 1 at Eastern Market, but there is no Shed 1. Kitchens and training are to be part of the Shed 4 renovation. What does this refer to?
- Generally, if the State were providing sufficient “supportive measures” the City’s financial conditions would be significantly improved, and might not require a Financial Stability Agreement. Is there any objective standard for determining that State support could enable the City to terminate the FSA, other than achieving “financial stability?”

### **Conclusion**

A brief summary of the effects of the proposed agreement, as noted above, is that it retains virtually all of City officials’ existing powers, with oversight and collaboration of a Financial Advisory Board (FAB) and a Program Management Director (PMD), as well as the State Treasury Department.

However, in the event of disputes about City government officials’ choices in opposition to those of State overseers and the Program Management Director (“Reform Default Conditions”), it provides for transferring the powers of City government to them, at least in areas where such disagreements and failure to follow State directives exist.<sup>9</sup>

The basic mechanism of the agreement works essentially like a light switch; City government continues to have power until there is a “Reform Default Condition” in which the PMD and the FAB determine that they are not doing enough in some area of City government operations to pursue the State’s reform agenda. At that point, as to any issues the State deems necessary, the proposed Financial Stability Agreement would empower the State – like flicking a switch - to take over from City officials and control those areas of policy.

The relevant issues subject to such FAB and PMD control potentially extend to all of City government, beginning with notoriously controversial and expensive programs like PLD, DDOT, privatization, labor agreements, DWSD, pensions and other issues frequently debated within the “core City services” discussions that have been taking place for many, many years. (See Annex B – an updated version of which will presumably be provided by the administration this week, because the March 29, 2012 version cited inapplicable provisions of the FSA document.)

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<sup>9</sup> Council Member Jenkins raised concerns that an ordinance amendment such as the one contemplated in the FSA at Pp. 25-26, paragraph 3.6, may violate the provisions of the City Charter, and therefore, be outside of Council’s authority to enact. Consistent with the whole thrust of the proposed FSA, although RAD is unable to predict the ultimate outcome of any anticipated legal challenges, and indeed this specific budget ordinance amendment does not on its face appear to violate the Charter, it does appear that if reliance on any Charter provisions were deemed by the State Treasury Department, the FAB and the PMD to be a “Reform Default Condition,” it is the intent of this agreement that the Charter provision would be set aside. The statutory basis for the FAB’s authority to do this, outside Public Act 4, is unclear to RAD at this time, pending further research.

As is evident from the list of “pros” and “cons” set forth above, there is nothing like a level playing field between the City and other business and State government interests involved in this discussion. Under the State Constitution, local government entities are creations of the State. In other communities the State has sought to extend its power in this regard to its maximum effect through Public Act 4 “Emergency Managers,” leading to ongoing legal challenges and major public political controversies.

As briefly alluded to at the very end of RAD’s previous report dated March 25, 2012, the application of Public Act 4 to the City of Detroit, given its size, population, historic social, political and economic importance to the State of Michigan, and the resulting budget issues summarized in this report, has always been an extremely dubious policy “fit.” State legislation to effectively and equitably address the fiscal crisis of the City of Detroit, and the human and civil rights of its residents, would by definition have to be carefully crafted with specific attention to the issues of Detroit. That has not been done. The proposed “Fiscal Stability Agreement,” under Public Act 4 and the other State legislation referenced above, is the result of this undesirable policy environment.

This political backdrop of the proposed Financial Stability Agreement will challenge implementation and successful reform, whichever decision City officials make on the ultimate terms of such an agreement. It is elected officials’ prerogative, as Your Honorable Body knows, to accept or reject such an agreement, in the interests of the voters and residents of the City.